

VZCZCXRO3843

RR RUEHAG RUEHAST RUEHBI RUEHCI RUEHDA RUEHDBU RUEHDF RUEHFL RUEHIK
RUEHKW RUEHLA RUEHLH RUEHLN RUEHLZ RUEHNEH RUEHNP RUEHPOD RUEHPW
RUEHROV RUEHSK RUEHSL RUEHSR RUEHVK RUEHYG
DE RUEHTA #1400/01 2290304
ZNR UUUUU ZZH
R 170304Z AUG 09
FM AMEMBASSY ASTANA
TO RUEHC/SECSTATE WASHDC 6037
INFO RUCNCLS/ALL SOUTH AND CENTRAL ASIA COLLECTIVE
RUCNCIS/CIS COLLECTIVE 1839
RUEHZL/EUROPEAN POLITICAL COLLECTIVE
RUEHBJ/AMEMBASSY BEIJING 1207
RUEHUL/AMEMBASSY SEOUL 0868
RUEHKO/AMEMBASSY TOKYO 1909
RUEAIIA/CIA WASHDC
RUEHRC/DEPT OF AGRICULTURE WASHINGTON DC
RUCPDO/DEPT OF COMMERCE WASHINGTON DC
RHMFISS/DEPT OF ENERGY WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RHEFAAA/DIA WASHDC
RHEHNSC/NSC WASHDC 1394
RUEKJCS/JOINT STAFF WASHDC
RUEKJCS/SECDEF WASHDC 1296
RUMICEA/USCENTCOM INTEL CEN MACDILL AFB FL 0010
RUEHAST/USOFFICE ALMATY 1796

UNCLAS SECTION 01 OF 03 ASTANA 001400

SENSITIVE

SIPDIS

STATE FOR SCA/CEN, EEB/ESC
STATE PLEASE PASS TO USTDA

E.O. 12958: N/A

TAGS: [PGOV](#) [PREL](#) [EPET](#) [ECON](#) [KZ](#)

SUBJECT: KAZAKHSTAN: KMG HALTS KCTS NEGOTIATIONS, THEN
SEEKS NEW TALKS WITH COMPANIES

REF: A. ASTANA 0578
[1](#)B. ASTANA 0675
[1](#)C. ASTANA 0748
[1](#)D. ASTANA 1201
[1](#)E. ASTANA 1303

ASTANA 00001400 001.2 OF 003

[1](#)1. (U) Sensitive but unclassified. Not for public Internet.

[1](#)2. (SBU) SUMMARY: From recent discussions with energy executives and government officials, it is clear that negotiations over the Kazakhstan Caspian Transportation System (KCTS) have stalled. The key issue is whether and to what extent international oil companies (IOCs) will be allowed to take an equity stake in the project. The government of Kazakhstan wants to build, own, and operate the onshore pipeline and other related infrastructure, but the IOCs will not provide financing or volume commitments without equity participation in the project. The government sent a letter to the IOCs last week, requesting the resumption of negotiations. While the letter does not indicate flexibility in the government's position, it is encouraging that the parties are prepared to continue negotiations. END SUMMARY.

ENERGY EXECUTIVES EXPRESS FRUSTRATION

[1](#)3. (SBU) In July and August, the Ambassador met with key U.S. energy executives with major investments in Kazakhstan, who provided an update on their negotiations with the government over KCTS. On July 21, Jay Johnson, Managing Director of Chevron's Eurasia Business Unit (please protect), told the Ambassador that the parties were very close to announcing an agreement on the eve of the Foreign Investors Council that President Nazarbayev hosted in Kostanai on June [1](#)2. He said that KazMunaiGaz (KMG) First Vice President

Maksat Idenov worked tirelessly with Chevron, representing the Tengizchevroil (TCO) consortium, and ExxonMobil, representing the Kashagan consortium (or G-6), to "hammer out a deal" that stipulated 49 percent ownership of the Eskene-Kuryk pipeline by the IOCs. Johnson said Idenov presented the proposal to Minister of Energy and Mineral Resources (MEMR) Sauat Mynbayev, who approved the deal. Then, unexpectedly, KMG President Kairgeldy Kabyldin "threw a handgrenade to kill the deal at the last minute." Johnson said Kabyldin introduced several new terms affecting the ownership structure and financing of the deal that the IOCs simply could not accept. He called Kabyldin "nationalistic" and said it seemed as if Kabyldin didn't want the IOCs owning critical infrastructure on Kazakhstani soil. Johnson said Kabyldin seemed to believe the government could take its time to complete the negotiations on KCTS, i.e., to build the system only when increasing production from Kashagan really requires it, after 2020. Johnson said it seemed as if Kabyldin were saying, "Why give away the infrastructure today, when I can wait until Kashagan comes on line? At least then, this deal won't happen on my watch."

¶4. (SBU) On July 31, the Ambassador met with Steve Rose, Caspian Russia Joint Interest Manager, and Mike Crews, Kazakhstan Country Manager, of ExxonMobil (protect throughout). They confirmed that negotiations on the onshore portion of KCTS, including the pipeline from Eskene to Kuryk, were very close to resolution in June, but came to a halt when the government introduced additional provisions at the last minute. Rose said Kabyldin demanded the unilateral right to (1) expand the capacity of the Eskene-Kuryk pipeline; (2) set or raise transit tariffs; and (3) authorize the front-end engineering design (FEED). According to Rose, Kabyldin also wants the option to buy out the IOC's equity stake in KCTS at any time. Rose said those terms were

ASTANA 00001400 002.2 OF 003

unacceptable to the G-6 and to TCO. "They want us to assume all of the project risk," he said, "without giving us any guarantees. We want sufficient control over the tariffs to ensure profitability of the system. We also believe that the owners of the project should determine when and how much to expand the pipeline -- not just the government. And we simply cannot commit to FEED until and unless we are an owner," with control of cost, risk, and other factors. Rose estimated the cost of the FEED to be \$100-200 million and said ExxonMobil would not commit this kind of money without ownership. Rose confirmed that Mynbayev had "blessed the outline of the agreement" (without the new terms introduced by Kabyldin), but when he saw Mynbayev on July 31, the Minister said the government was not ready to make a deal, and had made no progress on the MOU. Rose said Mynbayev did not seem angry or upset. According to Rose, as the meeting adjourned, he smiled, shook hands, and said, "We just need a time out." Rose and Crews said they will wait until the government "makes up its mind," but they insisted that either the government must build and finance the system on its own, using ship-or-pay contracts as collateral to raise capital on the open market, or it must include the IOCs as equal (49 percent) partners with ownership rights and authorities. "They can't have it both ways," said Rose.

VICE MINISTER SUPPORTS KCTS -- "BUT WHY THE RUSH?"

¶5. (SBU) On August 10, Energy Officer asked Vice Minister of Energy Lyazzat Kiinov how important KCTS is to Kazakhstan. He replied, "It is very important. Even if CPC is expanded, which we expect to happen next year, there will not be enough capacity for Kazakhstan's crude exports. The Atyrau-Samara pipeline is old, Soviet infrastructure, and in need of modernization. We will definitely need KCTS for TCO's future growth, Karachaganak's Phase III, and Kashagan. But we don't need it now. There is no rush. We won't have the big increase in volumes until 2013 at the earliest. Why take the risk to build the infrastructure now, without the

certainty that the oil will be there? And why rush to train all these new sea captains and officers now, when we won't have the tankers for another four or five years? They'll come back from training in six months, and who will then give them a job?" Kiinov said that KCTS will require large tankers (up to 63,000 deadweight tons) and said that the government has received expressions of interest from Russia, Azerbaijan, and Iran to build the tankers for Kazakhstan. But he said, "We don't want to give up the contract for the tankers. We want to attract an investor who will build the ships in Kazakhstan." (NOTE: As reported in reftel A, it is expected to take at least three years to build the onshore pipeline, oil terminals, and offshore buoys for KCTS, and up to eight years to train fully accredited sea captains. END NOTE).

KMG DISAPPOINTED THAT USTDA WILL NOT FUND FEASIBILITY STUDY

16. (SBU) On August 10, Arman Darbayev, KMG's Director of Oil Transportation Projects, met with visiting USTDA officials to discuss possible assistance to expedite vessel clearance at Kazakhstani ports and ensure that Kazakhstan's maritime legislation meets international standards (reftel E). Darbayev's first question to USTDA was, "Why did you back out" from financing a feasibility study for the trans-Caspian portion of KCTS? He said that KMG was very eager to have USTDA carry out that work. USTDA responded by noting that the IOCs are still engaged in negotiations with the governments of Kazakhstan and Azerbaijan over the structure and ownership of that portion of KCTS, and USTDA did not want

ASTANA 00001400 003.2 OF 003

to get ahead of those negotiations. Darbayev was disappointed, but he said that KMG and the State Oil Company of the Azerbaijan Republic (SOCAR) would have the estimated \$3 million and technical expertise required to carry out the work, independently of the IOCs. Darbayev said the engineering studies "will take years" to complete and he pushed for a parallel approach, in which the feasibility studies would be carried out even as negotiations over project ownership and volume commitments continue. He said, "We need the technical details in order to reach agreement on commercial issues." Darbayev also told USTDA that the government of Kazakhstan is still willing to grant the IOCs an equity share of the Eskene-Kuryk pipeline. However, he did not discuss the ownership structure for the oil terminals or offshore infrastructure, which falls under a 50-50 joint venture between KMG and SOCAR. (COMMENT: To the best of our knowledge, negotiations between KMG and the IOCs have focused solely on the construction of the Eskene-Kuryk pipeline and related onshore infrastructure. The port facilities in Kazakhstan and Azerbaijan are expected to remain under the stewardship of the host country. If that is the case, the companies will insist on clear, stable, and strictly enforceable terms to ensure a fair and transparent fee for the use of the ports. The IOC track record with the ports of Aktau and Baku suggests that this is possible, but not easy. END COMMENT). Darbayev confirmed to Energy Officer that in June, the IOCs and KMG were "very close to an agreement on KCTS. We had a two-page MOU ready for signature," he said, until a senior government official (NOTE: Likely KMG President Kabyldin. END NOTE) introduced additional terms that the IOCs refused to accept. Darbayev also disclosed that the IOCs demanded that the contract have fiscal (tax) and legal stability, but the Ministry of Finance refused to guarantee that. Darbayev said that KMG is eager to continue discussing the project, and said that Kabyldin sent a letter to the IOCs on August 9, asking them to resume negotiations. However, he indicated that KMG will still insist on the new terms and conditions it introduced in June.

17. (SBU) COMMENT: The negotiations over KCTS will continue to be complex, arduous, and time-consuming. That fact will neither surprise nor deter any of the oil companies doing business in Kazakhstan. We find it reassuring that the

government has already expressed its desire to return to the negotiating table, and we find it curious that a technocrat like Kabyldin could overturn an agreement reached with the Minister of Energy. Our expectation is that Mynbayev, Kabyldin, and Idenov will discuss the issue of IOC equity ownership with Prime Minister Masimov, who has proven his ability to resolve internal conflicts and forge consensus. We believe that Masimov can get the wheels moving in the right direction on KCTS. Post will continue to monitor the situation and will explore who is driving the government's decision-making on this important oil-export project, and whether this represents a trend toward greater national control over critical infrastructure. END COMMENT.
HOAGLAND